

**Testimony of
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**On behalf of
The Newspaper Association of America**

**Before the
President's Commission on the United States Postal Service
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Introduction

Good morning. My name is Gary Pruitt and I am Chairman, President, and CEO of The McClatchy Company. Headquartered in Sacramento, CA, The McClatchy Company owns and publishes 22 newspapers in four regions of the country—Minnesota, California, the Carolinas and the Northwest (Alaska and Washington). These newspapers range from large dailies serving metropolitan areas to non-daily newspapers serving small communities.

I appear before the Commission today as a member of the Newspaper Association of America's (NAA) Board of Directors and as Chairman of the NAA Postal Affairs Committee. NAA is a national trade association headquartered in Vienna, Virginia, that represents nearly 2,000 newspapers in the United States and Canada, accounting for nearly 90 percent of the U.S. daily circulation. While most NAA newspapers are dailies, many weekly newspapers are also members.

The Commission has a historic opportunity to fix the problems that face our nation's postal system and to set the Postal Service on a path of better service, greater operating efficiency and sounder finances. I commend you for answering the President's call to study the nation's postal system and help articulate a future course for the U.S. Postal Service. Newspapers specifically appreciate the opportunity that you are giving us today to provide some insight that may be useful in your deliberations.

My testimony will discuss the newspaper industry's views concerning the necessary and appropriate steps to improve the U.S. Postal Service as a cost-effective and accountable public service that will be financially strong for years to come. Our

recommendations stem from our direct experience as long-established mailers who have observed an unaccountable Postal Service repeatedly straying from its public mission and attempting to divert advertising from our pages. I also present our views on the opportunities and consequences of so-called Postal Service “partnerships” with private sector firms. Finally, attached to my testimony is a report prepared by postal economist J. Gregory Sidak of the American Enterprise Institute, which contains specific recommendations for improving the Postal Service. These recommendations address many of the Postal Service problems and challenges that are outlined in my testimony.

I. Newspapers And The Postal Service

The relationship between newspapers and the post office is as old as the nation. The first postmaster general – Benjamin Franklin – was a newspaper publisher, and the nation’s postal system was largely created to deliver newspapers so that citizens settling the American frontier could stay connected and informed. Throughout our history newspapers have served as partners with the Postal Service in helping fulfill the mission, established in the Postal Reorganization Act, of “binding the nation together through the personal, educational, literary, and business correspondence of the people.” For nearly two centuries, Congress has affirmed the importance of newspapers and other periodicals by adopting policies supporting their educational, scientific and cultural information values.

Newspapers today are among the leading local users of postal services and, collectively, the industry spends an estimated \$700 million annually across all classes of mail. Newspapers depend upon the Postal Service, each day, for the delivery of

newspapers and our advertising mail products (typically pre-printed inserts) to homes that do not have newspaper subscriptions. Newspapers also have a strong interest in First-Class mail as, unlike most businesses, we collect the majority of our revenues through the mail.

Newspapers, whether large or small, daily or weekly, serve as vehicles for news and advertising. Generally, there are two kinds of newspaper advertising. One commonly called “ROP” (“Run of Press”) is printed on the pages of the newspaper. The other, called “pre-prints” consists of free-standing inserts, which are placed inside the folded newspaper. Direct mailers, who are among the Postal Service’s largest customers, compete for both types of advertising, but most commonly for pre-prints.

While my testimony today will address Postal Service competition with the private sector, newspapers view themselves as dedicated consumers of postal services but have been treated as competitors by a Postal Service that has lost its way. As postal consumers who rely on mail delivery every day, newspapers want a healthy and vibrant U.S. Postal Service to serve our needs—and the needs of the nation—for generations to come.

II. The Postal Service Is A Public Service

Congress established the U.S. Postal Service as a fundamental public service with a mission of providing universal mail service at affordable and non-discriminatory rates. We believe this approach, which is as old as the Republic, is the right one.

To help the Postal Service accomplish this public service mission, Congress granted it a wide range of important and powerful privileges. The Postal Service has a

legal monopoly over the delivery of letter mail (which accounts for the vast majority of the Postal Service's revenues). It has the unprecedented power to define the scope of its own monopoly. It enjoys numerous advantages owing to its governmental status—it pays no taxes; it is exempt from most federal, state and local regulations; and it has privileged access to, and can borrow with the full faith and credit of the U.S. Treasury. It can determine its own revenue requirement and, although the Postal Service must run rate changes by the Postal Rate Commission, it has the power to modify the Commission's rate recommendations.

Surprisingly, despite all this, the Postal Service complains about being subject to rate regulation. Regulated utilities around the nation would rejoice to operate under such "restrictions."

I mention these privileges and special powers to emphasize that the Postal Service is far from an ordinary business. It is a mammoth organization with personnel in nearly every city and hamlet in America. Last year it had some \$66 billion in annual revenues, a huge sum that dwarfs the revenues of any newspaper company. (USPS revenues are more than *sixty times* the total revenue of The McClatchy Company, the ninth largest newspaper company.) As big as the Postal Service is, it is essentially accountable to no one. I have already mentioned the limited role current law assigns the Postal Rate Commission. The Postal Service has no shareholders. And while Congress holds many hearings on USPS, it has neither the time nor attention to hold the Postal Service accountable.

These circumstances, in total, have resulted in a USPS that is vast and huge, one that has a profound effect on the nation's economy, including adverse effects on

secondary markets such as the distribution of advertising. The Postal Service's combination of size and scope, together with little accountability, has allowed it to stray from its public service path. It has gotten off this path by directing its attention to increasing its volume, rather than focusing on providing postal services.

III. The Postal Service Has Strayed From This Core Public Service Mission

As noted, the Postal Service should provide a public service at affordable and non-discriminatory rates on a financial break-even basis. However, unable to control the costs of its ever-increasing distribution system, the Postal Service has for many years followed a strategy of growing mail volumes, at all cost. And it is the lack of effective oversight and accountability under the current law that has allowed this to happen.

The USPS's focus on volume growth as its principal goal is mistaken for several reasons. First, it is not what the law requires. Nowhere does the Postal Reorganization Act instruct the USPS to attempt to maximize its volume. Second, in this quest to maximize volume, the Postal Service improperly has taken sides in the private competition for advertising services. In particular, the Postal Service has followed a deliberate strategy of attempting to increase its volume of advertising mail by targeting the advertising revenues upon which we depend to support the news and editorial content of our newspapers. The Postal Service has done so both on its own, and through a wide range of initiatives that favor our competitors – direct mailers –over newspapers. While we have no problems with competing with other private businesses in the advertising marketplace, it is not appropriate that the government take sides in that competition, as we believe the Postal Service has done.

You do not have to take my word for this. The Postal Service itself clearly presented its goal of deliberately attempting to harm newspapers in favor of direct mailers in its United States Postal Service 1998 Marketing Plans, which stated as one of the agency's objectives:

Ultimately to establish "day certain" delivery for selected categories of Ad Mail, and create the platform for moving substantial revenues from pre-printed [newspaper] inserts into the mail.¹

Since this declaration, the Postal Service's actions have spoken louder than its words.

- The USPS launched an experimental program called Auto Day that would have spent \$10 million on an advertising and sales program to divert automobile advertisements from the Milwaukee Journal into the mail. After much criticism from Congress, newspapers, and the public the program was pulled;
- A month ago, newspapers learned that a "sales force" of Postal Service employees are making sales presentations to newspaper advertisers across the country encouraging them to use direct mail advertising over other media through the Postal Service's NetPost Mailing Online; and
- USPS spends millions out of its \$100 million advertising and marketing budget touting direct mail over other advertising media. Our concern is not with the merits of advertisements promoting direct mail over newspapers, but who pays for it. Such advertising should be funded by the direct mail industry, not the government through the Postal Service.

These efforts are merely the tip of the iceberg. For decades the Postal Service has tilted the playing field toward advertising mailers through not only its advertising and operational practices (which the USPS contends are managerial discretion and not subject to Postal Rate Commission review) but also through its costing and pricing initiatives. The Postal Service repeatedly has proposed to shift costs off of advertising mail onto

¹ United States Postal Service 1998 Marketing Plans, October 1997 at AD page 40.

First-Class Mail so that bulk saturation advertising mail rates can be lowered or minimally raised, while First-Class rates increase. We also believe it has failed to attribute accurately the costs of advertising mail, particularly the costs of letter carriers. However, because the Postal Service has failed to update costing data for letter carriers that was developed in 1986, newspapers—and the Postal Rate Commission—are limited in what can be done to substantiate this claim.

When Congress enacted the Postal Reorganization Act, no one expected that the Postal Service would choose sides in the competition for advertising. Instead, the Postal Service has adopted and expanded a posture over the years that it should act as though it has a financial interest in the advertising market. In the USPS 1998 Marketing Plans, the Postal Service stated that it “is taking a position of leadership in the Direct Mail industry as the owner of the medium.” Later in the report the Postal Service says that it “can no longer rely on others to grow the business enough to meet our revenue needs in the future.”² The Postal Service continues to advance this misperception that it is in the direct mail business. One need look only at page L-6 of its Transformation Plan where the Postal Service describes the saturation advertising mail with which newspapers most directly compete as a “low hanging fruit.”

Although our experience has been real and direct, the advertising market is not the only place where the Postal Service has taken a direction unanticipated by the Postal Reorganization Act. The Postal Service has lost millions in non-postal ventures, such as the selling of clothing, coffee mugs, videos, telephone cards, bill processing services, and

² *Id.* at AD 7, 8.

e-commerce services. These money-losing services for the most part are not subject to review by the Postal Rate Commission. What this history teaches is that, left on its own, the Postal Service will continue to veer off course and become something it was never intended to be. It is not a “communications” firm; it is a postal delivery system that has lost its focus and has not been held accountable.

IV. The Postal Service Has Abused Its Letter Mail Monopoly

The Postal Service’s loss of focus and lack of accountability have resulted in harm. Not only has it distorted markets by throwing its \$66 billion weight around, but Postal Service actions have increased prices and constrained services for the vast majority of mailers – the ones who use First-Class Mail. Thus, the Postal Service appears to have done great damage to its most important service.

As you know, the Postal Service holds today the only remaining legal monopoly in nationwide “utility” services. Newspapers support the existence of this monopoly as the most effective way to achieve the Postal Service’s core public service mission (and we do not object that the USPS has certain governmental advantages), but we strongly object to the Postal Service misusing its monopoly.

Let’s start with the price of a basic First-Class stamp. The Postal Service likes to boast that the rate for a single-piece basic First-Class stamp (now 37 cents) has kept pace with inflation since the Postal Reorganization Act. Rather than a source of pride, this should be a source of alarm. The price of a telephone call has fallen dramatically over the same years, and by merely staying put the Postal Service has not kept pace. This is particularly disturbing, given the huge investments in highly sophisticated sortation

equipment over the past decade and the widespread use of barcoding. All of this suggests that First-Class Mail rates are higher than they should be.

Further evidence of the problem is the grossly disproportionate share of overhead costs borne by First-Class Mail. For example, in Fiscal Year 2002, First-Class Mail continued to pay a far greater share of the institutional costs of the system than Standard Mail, the second-largest class. The facts are these:

First-Class Mail: 17.3 cents contribution per piece toward institutional costs

Standard Mail: 5.9 cents contribution per piece toward institutional costs

That First-Class Mail has been saddled with a disproportionate share of the costs is evident from the following comparison:

	% Revenue	% Volume	% Attributable Cost	% Weight
First-Class Mail	54.9	50.5	46.5	17.5
Standard Mail	23.7	43.0	26.0	42.0

By any measure, First-Class Mail pays a greatly disproportionate burden of the costs of the system, and this pattern has endured for many years.

Although the Postal Rate Commission has rejected some of the Postal Service rate proposals, it lacks the powers to prevent the placement of this burden on First-Class. It has no power to keep the Postal Service on proper focus or to refocus it on universal mail delivery; it can merely recommend rates. And even the Commission's powers to recommend rates are limited by its lack of authority over the revenue requirement, its

lack of final authority over rates and the Postal Service's ability to control and limit the cost data.

One key point, which has not been sufficiently discussed in the public debate over the years, is that the Postal Service protects its ability to exploit First-Class Mail by what is known as content restriction. Postal regulations compel nearly all personal and transactional correspondence to be mailed at higher First-Class rates. The content restriction between First-Class and Standard Mail restricts the variety of price and service choices available to First-Class mailers. Consumer frustration with the limited range of price and service options available to mailers may be one reason First-Class Mail is moving toward electronic communications.

Certainly, if the content restriction is removed, a wide range of price and service options could be available to hundreds of millions of individual and business mailers. One would expect such choices to be based upon considerations of speed of service, security against inspection, tracking of progress through the mail system, and size or shape of the piece.

The Postal Service has used revenues obtained through the excessive First-Class rates and captive monopoly customers to finance disproportionately low bulk advertising mail rates as well as to fund its numerous money-losing ventures. The problem the USPS now faces is that these decades of exploiting its monopoly may finally have killed the golden goose, and now it – and the mailers who have enjoyed low rates for years – are scrambling to avoid the consequences.

V. USPS Should Be Given The Flexibility To Control Costs

The Postal Service has undertaken an enormous effort to evaluate its entire distribution network to determine the optimum number, size, location and function of mail processing facilities, and realigning these facilities with its equipment, personnel and transportation network. Newspapers applaud the Postal Service for this effort to improve the efficiency of its distribution network. It would be extremely disappointing and counterproductive if the Postal Service were unable to implement changes in its distribution network because of congressional intervention. Newspapers believe the Postal Service should be given the operational flexibility to close or consolidate mail processing facilities and post offices that do not meet reasonable public service and productivity standards.

VI. “Pricing Flexibility” And Negotiated Service Agreements Would Only Aggravate The Postal Service’s Lack Of Accountability And Loss Of Focus

The Presidential Commission should examine quite skeptically the Postal Service’s plea of “pricing flexibility” and negotiated service agreements (NSAs). The USPS often dresses these concepts up as forms of “private-sector” partnerships.

What the Postal Service really means by “pricing flexibility” is the ability to reduce rates selectively, without effective prior oversight by the Postal Rate Commission or any real accountability. The Postal Service seeks this “flexibility” because it would further enable the Postal Service to pursue its volume-maximizing strategy by favoring the nation’s largest mailers. High on its list is the ability to negotiate individualized service agreements with selected mailers, offering rate breaks unavailable to others generally.

It is no surprise that large, national mailers favor such NSAs, as they have every reason to believe they could negotiate a good deal for themselves. Smaller mailers justly fear their postage rates will inevitably go up to pay for reduced rates for others. Small mailers are unlikely to have the clout necessary to attract the Postal Service's interest.

Although newspapers are often the largest mailer in their local markets, we believe the market has no room for "pricing flexibility" by government entities that have no shareholders, pay no taxes, enjoy government privileges and immunities, and exist on a history and infrastructure paid, to a substantial degree, by taxpayers. The Postal Service should not be picking and choosing among its mailers, favoring some, but not others, with special deals. Government services, such as postal services, should not be for sale on the basis of negotiating or lobbying skills.

This is particularly the case where the Postal Service's actions can have dramatic effects. One can imagine the impact of a \$10 million AutoDay campaign in the Milwaukee market; an impact no after-the-fact review could do much to cure. Where is the accountability? Who puts pressure on postal management when it negotiates a bad deal? What is the recourse for the private sector that suffers harm as a result?

I want to be careful to contrast these types of improper "flexibility" with the commendable use of widely available worksharing discounts. These are a type of "private-sector partnership" that, by allowing all eligible mailers to reduce Postal Service costs, are a good thing. Postal rates today include numerous generally-available discounts for so-called "worksharing" activities such as barcoding, dropshipping, and presorting. Mailers large and small can perform these activities, and both they and the Postal Service benefit. For our part, newspapers have invested huge sums in worksharing

efforts that reduce the Postal Service's costs while improving the service that our products receive.

I urge this Commission to come down strongly and unequivocally in support of private-sector partnerships that are genuinely open to all and are based on avoided cost. By working together with all mailers, the Postal Service will be far better off than if it devotes its time to cutting special deals with mailers with whom management has cozy relations and taking sides in competitive downstream markets.

NAA RECOMMENDATIONS FOR REFORM

The Postal Service's Transformation Plan discusses three models for its future: (1) government agency, (2) privatization, and (3) a commercial government enterprise ("CGE"). The Postal Service prefers the "CGE" model. Newspapers believe this proposed model is misguided and urge this Commission to recommend reforming the Postal Service into a properly focused governmental agency.

A. The Postal Service Should Be A Properly Focused Public Service, Not Commercialized

Let me comment on why we believe that the Postal Service's proposal for a CGE is the wrong course. Simply put, commercialization means freedom for the Postal Service to continue the same mistakes, including its failure to control costs, but with even less oversight and accountability than under the current regime.

Indeed, a good case can be made that the USPS today is already closer to the CGE model than to a true public-service government agency. Certainly its penchant for mission-creep beyond postal services into "communications," its constant effort to

expand into electronic and other money-losing lines of business, and its eagerness to cut special deals for individual mailers, suggest that key parts of the agency have already moved considerably away from the public service model.

The Postal Service needs more accountability, not less. It needs effective and independent oversight, not more “freedom” to misuse its \$66 billion monopoly without any meaningful supervision. And, given the Postal Service’s immense size and economic effects, prior review of new services and rate changes is essential. Giving the Postal Service license to proceed even more sharply down the path of a commercial entity, or the “flexibility” to cut special deals with selected mailers, will make matters significantly worse, not better.

B. Our Recommendations For An Improved, Refocused Postal Service

We urge this Commission to recommend refocusing the Postal Service on its core public service mission, with increased and effective oversight by a strengthened Postal Rate Commission. The Newspaper Association of America endorses the recommendations set forth in the attached report prepared by preeminent postal economist, J. Gregory Sidak. The cornerstones of these recommendations are (1) real authority in an independent Postal Rate Commission to inject the accountability now lacking; and (2) specific recommendations for postal reform in the areas of universal service, costs, rate and classification design, the postal monopoly, and market entry and exit.

These proposed reforms should expedite rate and classification changes while preserving the important principles of prior, independent review. The proposals would remove the fox from the hen house by shifting authority over the revenue requirement to

the regulator while giving the Postal Service appropriate latitude to reduce large categories of costs. We propose that the Postal Rate Commission conduct a thorough evaluation of the meaning and scope of universal service. This would identify the costs of universal service, a basic fundamental issue that to date has never really been resolved.

Our recommendations would also improve core letter mail services by changing the basis for pricing letter mail to service and cost characteristics rather than their content and by lowering excessive rates. They would also help to reduce pressure on letter rates by establishing the independent review – now absent – of the Postal Service’s decisions to enter new markets, and by clarifying the legal standards that would govern anti-competitive acts outside of the Private Express Statutes.

NAA believes that through these recommendations the consumer would realize increased benefits, the Postal Service will become an improved and cost-effective public service, and the postal rate setting process will become fairer, more transparent and less time consuming.

C. Specific Recommendations Reform

Universal Service

- The universal service obligation (USO) should be thoroughly reevaluated, taking into account electronic substitution, among other market factors.
- The Postal Rate Commission (PRC), not the Postal Service, should define the USO and determine the cost of the USO.
- The PRC should have the authority to set productivity and service-quality targets for the Postal Service.

Costs

- The PRC should be able to reject the Postal Service's proposed revenue requirement and establish an alternative revenue requirement.
- The PRC should establish, outside a rate case, the methodology for calculating attributable and institutional costs, and for allocating institutional costs to classes of mail.
- The PRC must have the power to subpoena the Postal Service to produce and make available cost information and other relevant data.
- The Postal Service should have the operational flexibility to cut large categories of costs.
- The PRC should be empowered to disallow the recovery through rates of any cost item—including labor costs and capital expenditures—that it determines is excessive, imprudently incurred, or otherwise unjustified.

Rate Design and Mail Classification

- The content restriction in letter mail should be eliminated and the pricing structure for this type of mail should be realigned to the service being delivered.³
- The PRC should streamline rate cases by deciding costing and mail classifications in separate proceedings.
- The PRC should have the power to impose binding rates that the Postal Service cannot veto.
- The PRC should have the final authority to establish mail classifications.
- The Postal Service should not fund its USO with monopoly rents from any class of mail subject to the Private Express Statutes.
- Rate discounts should be available to all mailers and be based on avoided costs, not negotiating or lobbying skill.
- Volume discounts unrelated to costs should not be allowed.

³ The content restriction for letter mail is much different than Congress' long-history in providing preferential rates for periodicals and nonprofit mail because of the public policy considerations which support their educational, literary and cultural information value.

Postal Monopoly

- The power to interpret the Private Express Statutes and mailbox monopoly by regulation should be transferred from the Postal Service to the PRC.
- On appeals of final agency actions by the PRC, the Department of Justice should urge the U.S. Court of Appeals to construe the postal monopolies as narrowly as possible.
- The PRC also should enunciate the legal standard for predation and other acts of monopolization that would apply to the Postal Service's activities in markets outside its statutory monopoly.

Market Entry and Exit

- The PRC should have the authority to approve, disapprove, or impose conditions on Postal Service entry into new markets before such entry occurs. This standard for entry into new markets should be based on whether there is a market failure that needs to be remedied and whether market entry will result in undue effects on secondary market competition.
- The PRC should have the power to compel the Postal Service's exit from any market that is outside the core services covered by its USO.

CONCLUSION

Thank you for this opportunity to present the views of the NAA. I would be pleased to answer any questions that you may have.